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Report on Scottish Government Budget 2021-22

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Introduction

1. This report sets out the views of the Finance and Constitution Committee ("the Committee") on the Scottish Government's Budget 2021-22 and its Medium Term Financial Strategy (MTFS). It follows our pre-budget report which was published in December. The Committee thanks all those who provided written and oral evidence and our Adviser.

2. The Committee recognises that both the 2021-22 Budget and the MTFS have been published in highly challenging circumstances, given the continuing economic and fiscal uncertainty. The Cabinet Secretary for Finance ("The Cabinet Secretary") told the Parliament that the "exceptional circumstances require an exceptional response" and that Budget 2021-22 "provides for continuity in our urgent work to control the virus and to protect our economy and national health service while the vaccine is delivered as quickly and safely as possible." [1]

3. The publication of the UK Budget on 3 March means that the size of the Scottish Budget could change significantly. The Cabinet Secretary told the Parliament that there is a need to "persevere with a budget that is based on a partial settlement while we are left waiting until the UK budget to see the full hand that is being dealt to us." [2]

4. The Committee welcomes the agreement of the Cabinet Secretary to move Stages 2 and 3 of the Budget Bill to after the UK Budget. This will allow the Committee and the Parliament an opportunity to consider the impact of the UK Budget during scrutiny of Budget 2021-22.

5. The Committee notes that this is the second consecutive year in which the Scottish Budget has been published prior to the UK Budget. The Committee recognises that this was due to the UK General Election in December 2019 and then the exceptional circumstances arising from COVID-19. In both cases this has resulted in a truncated period for parliamentary scrutiny which makes detailed consideration of the Budget very challenging. The interconnectedness of the UK Budget and the Scottish Budget exacerbates this challenge.

6. The Committee recommends, therefore, that our successor committee should work with its counterpart committees in Wales, Northern Ireland and the House of Commons with a view to impressing on HM Treasury the benefits of better alignment between the devolved budget processes and UK fiscal events. The forthcoming review of the Fiscal Framework also provides an opportunity to address this issue.

UK Economic and Fiscal Outlook

7. In our pre-budget report the Committee considered the Office of Budget Responsibility's (OBR) economic and fiscal outlook (EFO) which was published in November 2020. At that point in the current crisis the OBR expected UK economic growth to fall by 11% in 2020 which is the largest fall in over 300 years although outturn data suggests the actual fall was 9.9%. In response the UK Government deficit was expected to reach nearly £400 billion which is the highest deficit since 1944-45 and the highest outside of wartime.

8. Since then the economic and fiscal impact of the crisis has continued to rapidly evolve. The OBR publish a monthly commentary on the public sector finances based on Office of National Statistics (ONS) data. The latest commentary on the December 2020 data stated that "the pace of government borrowing picked up further in December to reach £34.1 billion, the highest monthly total since May." This means that year-to-date borrowing now stands at £270.8 billion, "far exceeding the pre-virus annual record set at the peak of the financial crisis (£158 billion)." [3]

9. The Committee heard from the OBR on 27 January. While the OBR's next set of forecasts will not be published until 3 March they were able to provide us with a sense of how events have unfolded relative to their November forecast. They told us that there continues to be "an extraordinary degree of uncertainty about the economic and fiscal outlook" and that this originates from two sources—

- The path of the pandemic;
- Future trading relationship with the EU.

10. The OBR told us that the emergence of a more infectious and virulent strain of the virus and subsequent national lockdown since their November forecasts has been largely negative for the UK's economic prospects. However, the fact that the economy shrank by only 2.5 per cent in November helps to offset the impact of the new national lockdown. The OBR explained that this suggests that "consumers and businesses are becoming better adapted than we thought to lockdown conditions and to operating under those conditions." [4]

11. Looking towards their forecasts on 3 March the OBR explained that the progress of the vaccine programme is good news compared to their November forecast. However, the more virulent strain of the virus will mean that the number of people who must be inoculated before general public health restrictions can be lifted will also be higher. The OBR forecast in November that this point would be reached sometime in the second half of 2021 but they will have to revisit that assumption in preparing their March forecasts.

Future trading relationship with the EU

12. The UK's trade agreement with the EU "helped to avoid the further 2 per cent fall in output" that the OBR's forecasts "had said was associated with a no-deal Brexit." [5] The OBR's forecasts in March will be updated to reflect the details of the agreement and their estimates of its economic impact.

13. The OBR told us that since the EU referendum their forecasts “have factored in a long-run loss of output of about 4 per cent, which would have been associated with leaving the EU with a deal.” Our Adviser points out that part of this loss may already have occurred. While they will reassess that further to the deal being agreed they pointed out that until now “independent experts, including the governor of the Bank of England, have commented that they think that that estimate is broadly correct.” [6]

14. Looking forward to the OBR’s March forecasts they will look at the detail of the trade agreement, but “also assess that in the light of what we have seen at the border in the past month.” [7] The OBR highlighted a number of issues related to the implementation of the trade deal which they will need to assess in their March forecasts including —

- costs at the border from trading with the EU, not from tariffs but from paperwork, delays and compliance with things such as phytosanitary regulations;
- it appears that a lot of the checks are being applied relatively stringently at the moment, especially on the European side of the border;
- the degree of business preparedness for the new trading arrangements has been less than we might have anticipated;
- it also appears that businesses are not applying the rules of origin but are, instead, just applying customs tariffs for goods that might have originated outside the EU;
- trading volumes across the border have reduced by about 20 or 30 per cent over the past month or so.

15. The OBR also pointed out that they “are not yet sure how much of that is temporary for the next few months while businesses on the UK and EU sides become more familiar with the arrangements” or “how much of that will prove to be permanent.” [8]

16. A further area of uncertainty arises from other aspects of the UK’s trading arrangements which have yet to be agreed. While the deal largely covers trade in goods this only accounts for around 60% of the UK’s trade with the EU while services account for the other 40%. A memorandum of understanding on trade in services between the UK and the EU is under negotiation with a deadline of the end of March to come to some kind of agreement.

Borrowing

17. The Committee discussed with the OBR how the UK Government’s fiscal policy might develop in the coming year in response to the crisis. The OBR told us that borrowing costs are currently “extraordinarily low, which alleviates pressure on Governments around the world to do anything about their fiscal positions.” [9] They explained that “the signal that markets are giving Governments is that they are happy to lend them the money that they need for the support that they are providing to employers and businesses to get us through the pandemic.” [10]

18. The Committee also discussed with the OBR, the Bank of England's role in financing Government borrowing. The OBR explained that the "intervention in the UK is happening through the gilt markets." The Government is issuing large amounts of debt and the Bank of England is "then intervening in the secondary market and buying up some of that from the primary purchasers." [11]

19. The OBR explained that the net effect on public finances is twofold—

    - it reduces the Government's overall debt servicing costs, because higher-interest longer-term debt is replaced by lower-interest short-term debt and goes from being a liability of the Treasury to a liability of the Bank of England; and
    - it dramatically shortens the overall net maturity of the public sector's debt, because the higher-rate longer maturity Treasury debt is replaced with lower-rate shorter-maturity Bank of England debt.

20. This means that Government borrowing with the support of the Bank of England is much cheaper now but it means that the Government is "much more vulnerable to any decision that the bank might have to make to raise interest rates in future, because that would immediately raise its interest payments." [12]

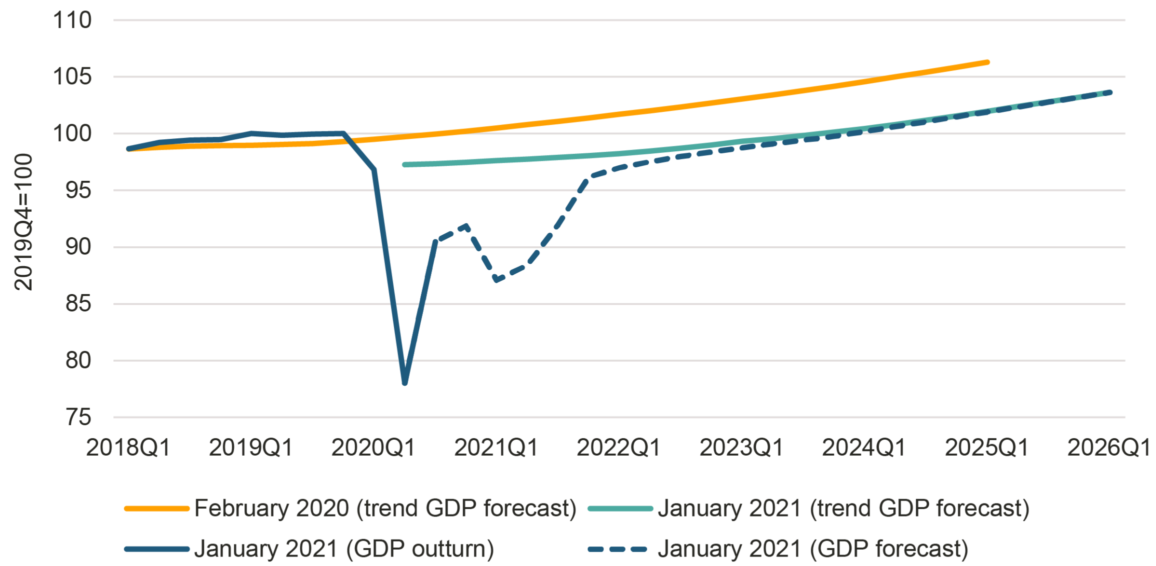
21. The Committee recognises that while the progress of the vaccine programme provides some room for optimism the UK's economic and fiscal outlook remains highly uncertain. The impact of the UK's future trading relationship with the EU also remains uncertain.

22. Given this continuing uncertainty and that borrowing costs are "extraordinary low" the Committee's view is that economic recovery from the crisis should be the priority in the next financial year rather than fiscal consolidation. At the same time, we note the view of the OBR that fiscal consolidation will be necessary in the medium-term particularly if interest rates rise and the cost of borrowing increases.

Scotland's Economic and Fiscal Outlook

23. The SFC state that the "Scottish and UK economies are both expected to contract by around 11 per cent in 2020 as a result of the COVID-19 crisis." [13] As shown in Figure 1, Scottish GDP fell by almost a quarter during the UK-wide lockdown in early 2020.

Figure 1: Trend and actual Scottish GDP, February 2020 and January 2021



Source: SPICe

24. The SFC expect GDP in Scotland to fall by 5% in the first quarter of 2021 as a consequence of the current national lockdown. They point out that the economic impact is less than the first national lockdown "as more sectors of the economy, including construction and manufacturing, remain open." [14]

25. The SFC forecast for 2021 as a whole is growth of 1.8 per cent and then 7.5% in 2022 as shown in Table 1. They explain that this "is mainly fuelled by household consumption as higher-income consumers who accumulated savings during the lockdown months start spending again." [15]

Table 1 - Scottish GDP Growth Forecasts

2020	2021	2022	2023	2024
-10.7%	1.8%	7.5%	1.6%	1.6%

Source: Scottish Fiscal Commission

26. The pandemic is expected to have "long-lasting effects on the Scottish economy." [16] The SFC don't expect Scottish GDP to recover to its pre-COVID-19 level until the start of 2024 and by 2025 it will still be 4 per cent below where they expected it to be in their February 2020 forecast.

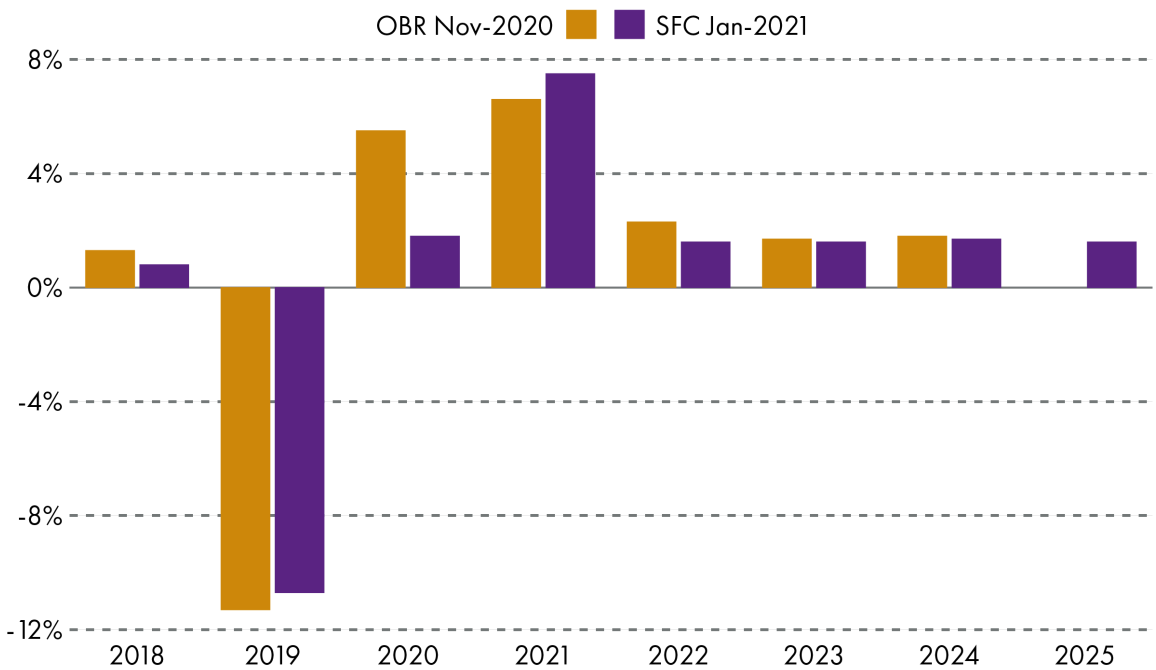
27. The SFC note that COVID-19 has been the dominant factor in producing their forecasts for the next five years and they "expect no quick return to 'normality' for

2021-22." [17] Broadly speaking, it assumes a fairly gradual decline in COVID-19 cases and deaths which require 'lockdown' restrictions in Q1, a slow relaxation in Q2 and some ongoing restrictions in Q3 (with the potential for restrictions to move up as well as downwards over time in at least some parts of the country), with restrictions only no longer required from Q4 2021. The UK government's Coronavirus Job Retention (furlough) Scheme is assumed to finish at the end of April, in line with current UK government policy.

28. Conversely, the OBR had assumed a lower level of restrictions in Q1 2021, broadly comparable with the restrictions in place in Tier 3 areas in England in October 2020, which allowed educational establishments, gyms and non-essential retail to open, as well as the opening of restaurants and pubs serving food to diners from the same household or support bubble. Restrictions would be eased from this lower level from Q2 2021, although the OBR unfortunately does not say when they assumed restrictions could largely cease.

29. Our Adviser suggests that these differences in assumptions – driven in large part by differences in information associated with the timing of forecasts – likely explain most if not all of the difference in economic growth forecasts produced by the SFC and the OBR and set out in Figure 2 below.

Figure 2: Comparison between SFC January 2021 Scotland and OBR November 2020 UK GDP % growth rates



Source: SPICe

Scotland-specific economic shock

30. The OBR's Gross Domestic Product (GDP) growth forecast for 2021 is 5.5% and 5.6% for 2022. The SFC forecasts GDP growth in Scotland of 1.8% in 2021 and 7.5% in 2022. Given these differences, the criteria for a 'Scotland-specific economic shock' [i] are met for the first time. Under the terms of the Fiscal Framework, this triggers additional borrowing and Scotland Reserve powers for the Scottish Government (discussed below).

31. However, as highlighted by SPICe, the triggering of this criteria "is more likely to be down to forecast timing issues rather than the Scottish economy being negatively out of kilter with the UK as a whole." As explained by the Fraser of Allander Institute (FAI), "anybody doing a forecast in January would have been more pessimistic than in November and therefore the trigger for the Scotland-specific economic shock is not a surprise." [18]

32. Both the OBR and the SFC have explained to the Committee that the overall economic impact of the pandemic has been largely symmetrical across the UK. The OBR told us that although there are differences in the sectoral composition of the rUK and Scottish economies "they are almost entirely offsetting" [19] in relation to the impact of the virus as shown in both the sectoral GDP data and in the real-time information from the PAYE system.

33. The OBR explained that "the balance between sectors that were hard hit by the pandemic and those that could survive the pandemic relatively untouched just about evened out across the border." [20] For example, while more people in England work in professional services and information and communications technology, more people in Scotland work in the health service and in public services. This means that "over the course of the pandemic, things have evened out" and the "Scottish and UK gross domestic products have moved closely together over the course of the pandemic." [21]

Future trading relationship with the EU

34. A further possible risk for the Scottish Budget is whether the future trading relationship with the EU might have a differential impact on the Scottish economy relative to the economy in the rest of the UK. The OBR told us that "there might be some differences but, if so, they are not enormous." [22] As noted above the biggest differences between the sectoral composition in Scotland and that in the UK are in the areas of information technology, professional services and healthcare. The OBR explained that most of these "are largely unaffected by the trade deal or cross-border frictions. Those are largely either non-tradable services provided to our own population or services that are outwith the deal." [23]

35. The SFC state that their February 2020 "forecasts already incorporated the long-run effects of Brexit on the Scottish economy and, because the deal was within the range of our previously expected outcomes, we continue to use the same assumptions for this forecast." [24] These assumptions are –

- new trading arrangements with the EU and others slow the pace of import and export growth;

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i A Scotland-specific economic shock is triggered when onshore Scottish GDP is below 1% in absolute terms on a rolling 4 quarter basis, and 1 percentage point below UK GDP growth over the same period. The shock may be triggered from outturn data or forecasts. In the event that forecast data shows an economic shock but outturn data does not, no retrospective revisions will be applied to borrowing powers.

- the UK adopts a tighter migration regime than that currently in place.

36. The SFC state that they have retained the same Brexit judgements we used in their February 2020 forecasts, “based on a smooth transition to a new free trade agreement with the EU on 1 January 2021” and that these are broadly in line with those used by the OBR in its November 2020 forecasts for the UK. The SFC also recognise that “there have been significant border problems affecting fisheries exports, trade between Northern Ireland and Great Britain, and other trade” but they “expect many of these problems to be short lived.” However, their forecast of slower growth in international trade is due to the “inevitable fact that Brexit increases border frictions.” [25]

37. The Committee notes that there does not appear any evidence of an overall differential impact on the Scottish economy relative to the UK economy arising from both the pandemic and the impact of the future trading relationship with the EU. This means that given the way the Fiscal Framework operates the Scottish Budget is relatively well protected from the continuing UK-wide economic shock.

38. However, as discussed in more detail below, the MTFS highlights a “considerable risk” that the Scottish Income Tax base might prove less resilient to COVID-19 and Brexit “simply due to differences in the sectoral composition of the two economies.” The MTFS suggests that this means differences are likely to emerge when business support measures such as the furlough scheme are withdrawn.

39. The Committee invites the Cabinet Secretary to explain what action has been taken by the Scottish Government to address this considerable risk.

Impact of Covid-19 on the Scottish Budget

40. The Cabinet Secretary states that "we cannot underestimate the scale of the challenge we face as a result of COVID-19" and that this "requires an unprecedented response, and investing in both the immediate resilience and longer-term recovery of our businesses, which this Budget seeks to deliver." [26] She states that the Scottish Government "will use the powers and resources available to us to provide a significant package of support for businesses, particularly those most impacted by the crisis." [27]

41. Given that it is clear that the fiscal response to the crisis will continue into 2021-22 it is highly likely that further Barnett consequentials will flow from the UK Budget on 3 March. The SFC have said that the UK Budget in March is likely to include additional UK spending on COVID-19 and that more funding later in 2021-22 is also probable.

42. It is also likely that further in-year adjustments to the UK Budget in 2020-21 in response to the pandemic will lead to further Barnett consequentials. The UK Government's final supplementary estimates for 2020-21 have yet to be published which means the amount of consequentials is not available. This is unusual given that the supplementary estimates are normally published in January and the Spring Budget Revision at the beginning of February.

Budget 2020-21 In-Year Revisions

43. In our pre-budget report we noted that HM Treasury had guaranteed £8.2 billion of COVID-related Barnett consequentials in 2020-21. Since then a further £1.5 billion has been guaranteed for 2020-21. An additional £400m was announced in December and then a further £1.1 billion was announced on 15 February.

44. With regards to the latter, HM Treasury has stated that "in recognition of the exceptional circumstances and in response to calls for flexibility, the Scottish Government will be able to carry over any of the £1.1 billion not spent this year into the 2021/22 financial year on top of their existing tools to transfer funding between years." [28] The Cabinet Secretary told the Parliament on 16 February that due "to our being at a late stage in the financial year, that money can and will be carried over into 2021-22." [29]

45. While around £6 billion of the Barnett consequentials have been allocated through the Summer and Autumn Budget Revisions the remaining £2.6 billion consequentials will not be formally allocated until the Spring Budget Revision (SBR), which is due to be published on 25 February. The Cabinet Secretary has, however, provided the Committee with updates and a summary is provided at **Annexe A**.

46. The allocations announced on 16 February are funded from a combination of the £180m of remaining contingency and emerging underspend that is being reprioritised. The SBR will set out a net allocation of the £8.6 billion but will have a

higher gross allocation offset by some re-prioritisation.

COVID-19 Funding in Budget 2021-22

47. The UK Spending Review in November 2020 provided COVID-19 related Barnett consequentials of £1.3 billion for Budget 2021-22. This is a significant decrease from the £8.6 billion of consequentials in 2020-21. But the UK Spending Review also highlighted that the UK Government was setting aside £21 billion in contingency funding in recognition of the fact that the "trajectory of the pandemic remains uncertain" and to "allow the necessary support to be put in place and adapted through the course of next year."

48. SPICe point out that this raises the strong possibility of further COVID-19 related expenditure in 2021-22, and resulting Barnett consequentials for Scotland. In view of this, the Scottish Government decided to plan on an additional £500 million of COVID-related Barnett consequentials in 2021-22 and has already allocated these to spending areas, along with the £1.3 billion already confirmed. Portfolio allocations are shown in Table 2.

Table 2: COVID-19 allocations by portfolio, 2021-22

Portfolio	£m
Health and Sport	869
Communities and Local Government	399
Finance	15
Education and Skills	68
Justice	72
Transport, Infrastructure and Connectivity	230
Environment, Climate Change and Land Reform	3
Rural Economy and Tourism	25
Economy, Fair Work and Culture	147
Total	**1,828**

49. The SFC told us that "given all the uncertainties about how Covid is going to develop over the year, the Government's assumption in its budget of an additional £500 million is pretty modest and cautious." [30]

50. In addition, as noted above, the Scottish Government has carried over £1.1 billion in late Barnett consequentials from 2020-21. The Cabinet Secretary announced on 16 February how she proposes to allocate that funding in 2021-22 and details are provided at **Annexe B**. The Cabinet Secretary told the Parliament that these proposals "are subject to parliamentary approval of the budget and will be taken forward in the event that our 2021-22 budget assumption of an additional £500 million of Covid consequentials is realised and that requisite funds are available via the Scotland reserve." [31]

Additional Fiscal Flexibilities

51. The Committee recognises that the COVID-19 related figures for both 2020-21 and 2021-22 remain a snapshot of a dynamic funding position which is likely to remain uncertain well into the next financial year. The Committee, as discussed in our pre-budget report, has also questioned whether the fiscal framework provides sufficient fiscal flexibility within a crisis.

52. The SFC's forecast of a Scotland-specific economic shock allows the Scottish Government to borrow £600m rather than £300m per year for forecast error on tax receipts and social security expenditure and removes the annual limits on drawdown from the Scotland Reserve. This applies in the financial years 2021-22 until 2023-24. These flexibilities will not be withdrawn retrospectively should revised forecasts or outturn data indicate that the central criteria for a Scotland-specific economic shock are not met.

53. Prior to these fiscal flexibilities becoming available the Committee wrote to the Chief Secretary to the Treasury (CST) in December requesting that they give further consideration to providing the devolved governments with greater access to borrowing in emergency situations such as the current crisis. [32] The Committee suggested that this could allow the devolved governments to tailor their own spend and policy response to the pandemic and economic recovery In Scotland depending on how this evolves differently from the situation in England.

54. The CST responded that he has "shown willingness to be flexible in exceptional times whilst also adhering to the agreed fiscal framework." In his view the "Spending Review 2020 settlement, ability to carry funding forward into 2021-22, and the additional borrowing and reserve flexibility provides the Scottish Government with substantial funding and flexibilities for 2021-22." Further to his response, as noted above, further fiscal flexibilities have been announced by HM Treasury.

55. The Cabinet Secretary has also repeatedly requested greater fiscal flexibilities so that the Scottish Government including greater borrowing and increased limits for the Scotland Reserve and increased end-year flexibilities. As noted above the triggering of a Scotland-specific economic shock provides the Scottish Government with temporary access to increased Scotland Reserve and borrowing flexibilities.

56. Budget 2021-22 states that notwithstanding the increased flexibility provided by the triggering of a shock, the powers within the Fiscal Framework "are too restrictive to ensure stability in the Scottish Government's budget management" and "been an impediment to our pandemic response." [33] The MTFS states that the "current devolved funding arrangements have clear limitations in terms of managing risk, particularly in the face of economic shocks precipitated by COVID-19."

Underspends

57. The Scotland Reserve is the only formal mechanism for the Scottish Government to retain underspent funds for future years. The MTFS states that in managing the Reserve the priority is anticipated underspends which reflects the risk of funds

being lost to the Scottish Government should excess underspends emerge in the provisional and final outturn process. The Scottish Government points out that this limitation and the continual change in forecasts means that "it is neither feasible nor desirable for the Scottish Government to build up substantial balances in the Reserve." [34]

58. The spending plans in Budget 2021-22 include £431m of anticipated drawdown from the Scotland Reserve. The Scottish Government plans to drawdown £231m of resource spending as shown below.

Figure 2.5: Historic and planned use of the resource reserve

£ million	2019-20	2020-21	2021-22
Opening balance	381	217	231
Drawdowns	-249	-149	-231
Additions [1][ii]	85	162	
Closing balance	217	231	0
Source: Scottish Fiscal Commission, Scottish Government			
Shaded cells refer to outturn available at time of publication.			

Source: Scottish Fiscal Commission

59. As the SFC point out this assumes an anticipated underspend of £162m although "late changes to funding associated with the tightening of lockdown at the start of 2021 make it likely that further underspends will emerge for 2020-21." [35]

60. The Scottish Government also plans to drawdown £200m of capital spending as shown below.

Figure 2.8: Historic and planned use of the capital and financial transaction reserve

£ million		2019-20	2020-21	2021-22
Capital	Opening balance	65	80	10
	Drawdowns	-60	-70	0
	Additions	74	0	
	Closing balance	80	10	10
Financial transactions	Opening balance	159	136	202
	Drawdowns	-120	-4	-200
	Additions	97	70	
	Closing balance	136	202	2

Source: Scottish Fiscal Commission, Scottish Government[iii]

61. The planned drawdown is from the available balance of £202m of financial transactions within the Reserve.

62. Our Adviser suggests that "there is a strong likelihood of underspends being more significant, meaning a larger payment into reserves in 2020-21." The Scottish Government could carry forward an additional £269m on top of the £431m already assumed and still be within the £700m total limit for the Scottish Reserve. In addition to this, as noted above, the Scottish Government is now able to carry forward up to an additional £1.1 billion of Barnett consequentials. This is on top of the existing tools to carry over funding through the Scotland Reserve.

63. The SFC state that as "both the 2020-21 and 2021-22 budgets are facing significant uncertainty, underspends may be more volatile than in previous years, which

ii Additions to the reserve for 2020-21 are still uncertain and will be finalised as underspends emerge towards the end of the year. In this table we show the minimum addition required in 2021 to permit the drawdown in 2021-22.

iii Figures may not sum to totals because of rounding. Shaded cells refer to outturn avaliable at the time of publication. Additions to the reserve for 2020-21 are still uncertain and will be finalised as underspends emerge towards the end of the year increases the risk that they exceed the £700 million total limit and risk the Scottish Government losing funding which cannot be carried over." [36] The SFC's view is that "the £700 million limit remains a constraint that is particularly significant in comparison to the scale of change seen in the budget this year." [37]

64. The Committee notes that given many of the Scottish Government's Covid support schemes are demand led there could be underspends depending on take-up. The Cabinet Secretary's view is that given these two factors "flexibility over spending between financial years will be required." [38] She told us "managing the funding position over both years is an important element compared with previous years, but I monitor the position closely. We will ensure that no money is lost, but it might slip into next year." [39]

65. In particular, she emphasised that a key priority is to ensure "there will be no cliff edge on 31 March for the strategic framework business fund and other on-going supports" based on the "assumption that the UK Government will continue its own business support schemes, which will generate consequential funding that we can use to pay out through our strategic framework fund." [40] She explained managing support across the year end is so important given that it "is not that the need has gone away—it is just that when that funding has to be drawn down, it will be in the next financial year." [41]

66. The Committee recognises that the on-going uncertainty and volatility arising from the pandemic is likely to continue well into the next financial year. This means that significant in-year revisions are probable in 2021-22 both as a consequence of additional Barnett consequentials and the use of additional fiscal flexibilities. The Committee therefore agrees that the anticipation of £500m of further COVID-related Barnett consequentials is prudent.

67. There is also a possibility of amendments to the Budget Bill in response to the UK Budget on 3 March. The Committee's preference is that in order to allow sufficient parliamentary scrutiny that any such amendments are considered at Stage 2. Likewise, the Committee's preference is that the allocation of consequentials carried over from 2020-21 are included on the face of the Bill through amendments at Stage 2.

68. We also recommend, as considered by our legacy expert panel, that our successor Committee has the opportunity to scrutinise the budgetary position early in the new Parliament. While recognising it will be a matter for the incoming Government after the election, we are strongly of the view that the Parliament should have the opportunity to consider a Budget Revision prior to the Summer recess.

69. We note that the next set of SFC forecasts will be delayed due to the Scottish Parliament elections in May. We recommend that given the continuing economic and fiscal uncertainty and in order to support pre-budget scrutiny that these are published in September.

70. The Committee recognises that while there is technically a Scotland-specific economic shock, in reality the Scottish Budget has been largely protected from

the UK-wide shock. But at the same time the Committee welcomes the additional flexibilities as a consequence of how the Fiscal Framework works. However, how these flexibilities are employed and the consequences for future Budgets will need to be closely monitored by our successor Committee.

71. The Committee reiterates our recommendation in our pre-budget report that HM Treasury gives a commitment that if the fiscal position continues to rapidly evolve in 2021-22 that the funding guarantee for COVID-19 related Barnett consequentials should continue in the next financial year.

Scottish Income Tax

72. The Scottish Government's proposals for income tax rates and bands for 2021-22 are shown in Table 3 below.

Table 3: Proposed Scottish tax rates and bands, 2021-22

Bands		Band name	Rate (%)
Over £12,570 * - £14,667		Starter	19
Over £14,667	- £25,296	Basic	20
Over £25,296	- £43,662	Intermediate	21
Over £43,662	- £150,000**	Higher	41
Above £150,000**		Top	46

- *Assumes individuals are in receipt of the standard UK personal allowance (£12,570 in 2021-22)
- **Those earning more than £100,000 will see their personal allowance reduced by £1 for every £2 earned over £100,000

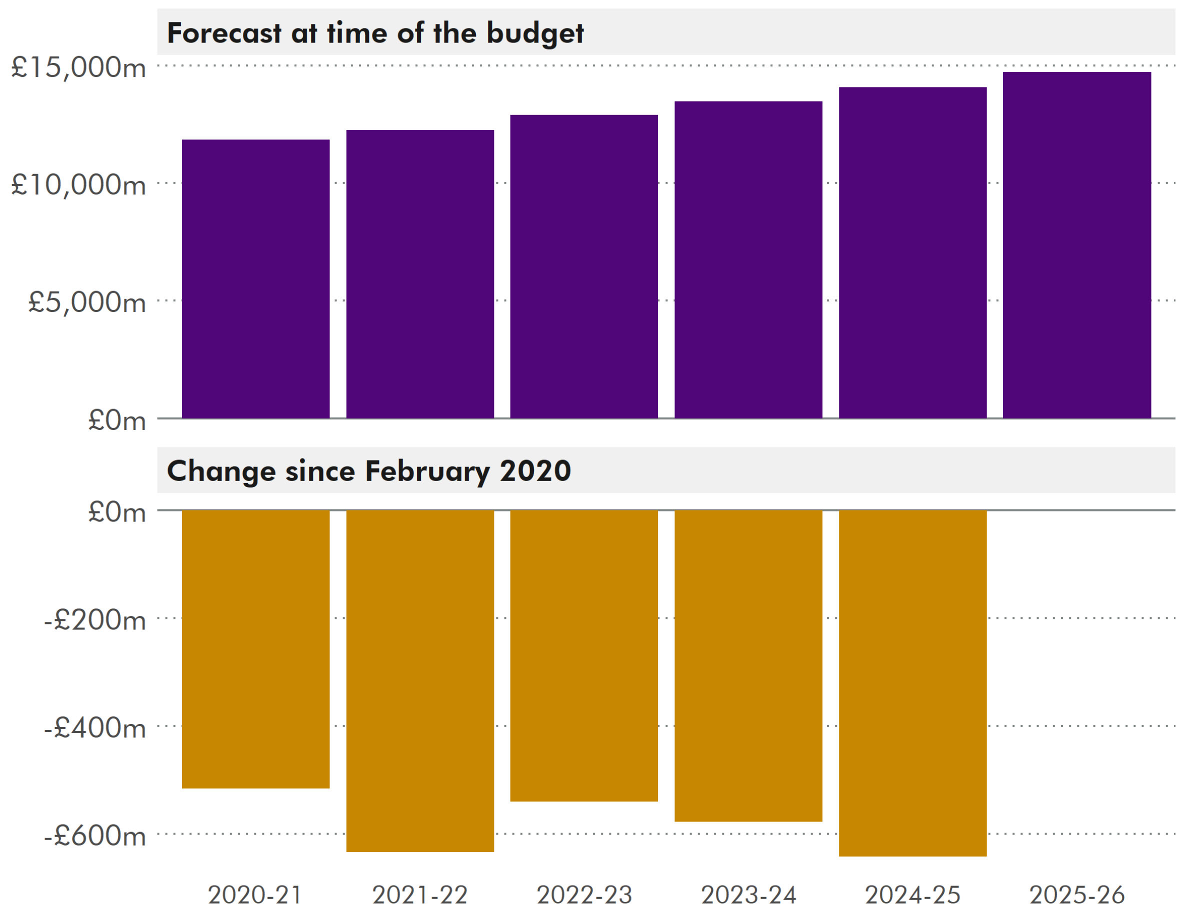
73. The Scottish Government state in the budget document that at "a time when people across our country are dealing with the economic and social impacts brought on by the pandemic, this policy delivers the certainty and stability they need from the tax system." [42] Income Tax rates will remain unchanged and the starter and basic rate bands, as well as the higher rate threshold, will increase by CPI inflation (0.5%). The top rate threshold will remain frozen in cash terms at £150,000, as has been the Scottish Government's policy since 2017‑18.

74. The Scottish Government's previous commitment to implement an "effective personal allowance" of £12,750 by the end of the Parliament has not been implemented. This is explained in the budget document as a consequence of "focusing on supporting those lower earners who are currently facing the most significant financial pressures, rather than delivering above inflation benefits for all Income Tax payers, including higher earners." [43] The FAI commented in a pre-budget blog that "this policy could cost upwards of £80 million" but "with no clear rationale, the government would be wise to conclude that this is a manifesto commitment worth breaking." [44]

Income Tax Revenue Forecasts

75. The SFC's forecasts for Scottish income tax receipts, alongside the OBR's forecasts for the associated Block Grant Adjustment, determine the revenue that the Scottish Government will be able to draw down from HM Treasury during the year ahead. The published forecasts for income tax across the forecast horizon are shown in Figure 3.

Figure 3: Non Savings Non Dividend (NSND) Income Tax forecast and change from previous budget's forecast

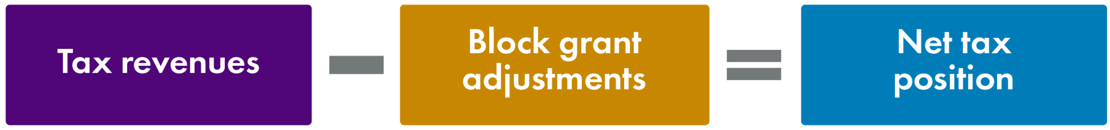


Source: SPICe

76. The SFC point out that their “economy forecasts play a key role in setting our tax forecasts so all of our tax forecasts use the broad-brush assumptions about the future impact of COVID-19.” [45] The headline figure is that the SFC’s income tax forecasts have fallen by £634m for 2021-22 since February 2020, primarily because of falls in employment due to the pandemic. The SFC forecast unemployment to peak at 7.6 per cent in 2021 Q2 once the furlough schemes end. Lower employment reduces the forecast by £458 million in 2021-22. With earnings more resilient, earnings changes only reduce the income tax forecast by £125 million in 2021-22. The impact of the SFC’s earnings and employment forecasts on the net tax position is discussed below.

Net Tax Position

77. After the Block Grant, the second largest part of the Budget is the net tax position. This is calculated as follows —



Source: SPICe

78. The net tax position in Budget 2021-22 is calculated using a provisional BGA based on the OBR November forecasts. The BGA will be updated based on the OBR forecasts published alongside the UK Budget on 3 March 2021. The Scottish Government has the option to continue to use the provisional BGAs or change to the updated BGAs. The net tax position will subsequently be reconciled with outturn figures and the difference applied to Budget 2024-25. Table 4 shows the forecast net income tax effect on the Scottish Budget across the forecast horizon.

Table 4: Forecast net income tax effect on the Scottish Budget

£ million		2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	BGAs forecast	-11,677	-11,788	-12,294	-12,840	-13,475	-14,105
Income tax	SFC forecast	11,850	12,263	12,907	13,481	14,080	14,718
	Difference	173	475	613	641	605	613

Source: SPICe

79. The income tax net position for 2021-22 has increased from £155 million in February 2020 to £475 million in January 2021. This means that the Budget will be better off by £320m which as the SFC point out is a significant increase in the expected funding available in the Scottish Budget for 2021-22.

80. A key question for the Committee is why the net tax position has significantly improved when there is no evidence of any differential impact of COVID-19 on the Scottish economy relative to rUK. The SFC are forecasting slower GDP growth in 2021-22 but significantly faster growth in income tax revenues.

81. The SFC's view is that "the difference between forecast tax revenues and the BGA largely arise because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in our and the OBR's income tax modelling." [46] They provide some possible explanations for this—

- The furlough schemes in particular have led to a significant disconnect between growth in GDP on the one hand, and growth in earnings, employment and income tax revenues on the other hand;
- Additional information since November on further COVID-19 restrictions, the extension to the furlough scheme, and additional RTI income tax data.

82. However, as the FAI point out "the relatively positive outlook for income tax seems difficult to reconcile with the point that the SFC's forecasts were made *after* stricter lockdown measures for 2021 had been announced, whereas the OBR's were made before." [47] In our pre-budget report we noted that the OBR forecast in November that tax receipts "bounce back in 2021-22 as the economy reopens, activity normalises, and earnings and profits recover." Furthermore, The MTFS states that there "is no evidence that Scotland's economic or tax performance has been

materially different from that of the rest of the UK in 2020-21." [48]

83. The challenge for the Committee in assessing the risk from forecast error becomes even more difficult when considering that the SFC "do not expect Scottish tax revenues actually to perform significantly differently to UK wide tax revenues in 2021-22." [49] The SFC's view is that the difference could reduce when the OBR publish updated forecasts in March.

84. Our Adviser points out that as well as differences in timing there would also appear to be significant differences in the judgements made by the SFC and the OBR. In particular, in relation to employment and earnings.

Employment and Earnings Forecasts

85. As shown in Table 5, the SFC's forecasts for employment also differ significantly from the OBR's. In particular, the SFC forecasts a larger fall in employment and increase in unemployment in 2020 and a smaller fall in employment and increase in unemployment in 2021 than the OBR. It also forecasts stronger growth in average earnings in each year of the forecast, with the exception of 2025. Our Adviser points out that the reasons for these differences are not explained by the SFC. We discuss this below.

Table 5: Employment, Unemployment and Earnings Growth Forecasts

Forecast	2019	2020	2021	2022	2023	2024	2025
Employment Growth							
OBR (Nov 2020) – UK	n/a	-0.4%	-2.2%	+0.8%	+1.5%	+1.2%	+0.5%
SFC (Jan 2021)- Scotland	+0.1%	-2.4%	-1.5%	+1.2%	+0.9%	+0.4%	+0.2%
Unemployment Rate							
OBR (Nov 2020) – UK	3.8%	4.4%	6.8%	6.5%	5.4%	4.5%	4.4%
SFC (Jan 2021)- Scotland	3.6%	6.0%	7.1%	5.9%	5.0%	4.7%	4.5%
Average Earnings growth							
OBR (Nov 2020) – UK	+2.9%	+1.2%	+2.1%	+2.0%	+2.4%	+3.0%	+3.5%
SFC (Jan 2021)- Scotland	+4.2%	+2.5%	+2.6%	+2.4%	+2.7%	+3.0%	+3.3%

Source: Committee Adviser

86. The SFC forecasts employment to fall by less and average earnings to grow by more in 2021 than the OBR forecast in November. The SFC told us that they expect a big increase in unemployment to 7.6% when the furlough scheme ends. They also explained that although we will have a lot of unemployment, we will also have a lot of mismatches across sectors and skills with some sectors being hit hard and struggling while others will struggle to find people who are qualified.

87. Overall it forecasts total earnings to grow by 1.8% in 2021-22, compared to the 0.0% expected by the OBR. Our Adviser suggests that this can probably explain around half of the faster growth in Scotland's income tax revenues.

88. He also suggests that a significant part of the other half is because it expects earnings growth to be more "tax rich" – that is each pound of earnings translating into more tax revenues. However, why this is the case is unclear. Our Adviser suggests it may be because the SFC expects more of the job losses to be among lower paid workers who pay relatively little tax, and/or more of the earnings growth to be among higher paid workers, who face higher marginal tax rates.

89. Our Adviser points out that the SFC is right that it is very unclear just how much the

usual relationships between GDP, employment and tax revenues will break down as a result of the furlough scheme. So, it is not surprising that the SFC and OBR have come to somewhat different and seemingly inconsistent judgements on how the economy, employment and tax revenues will evolve.

90. However, in his view it is surprising that the SFC did not forecast a bigger fall in employment given its assumptions about COVID-19 restrictions and recovery. He points out that the SFC does not provide much information on how it made its employment forecasts – including, for example, what share of workers that are furloughed that it expects to lose their jobs when the furlough scheme ends.

91. The Committee recognises that preparing fiscal and economic forecasts during the current crisis is highly challenging. But the unprecedented levels of volatility also significantly increases the risk of sizeable reconciliations in future years. In particular, given that the SFC has highlighted that it does not expect the Scottish income tax base to grow more quickly than the UK in 2021-22 there is a strong risk of a substantial negative reconciliation. This essentially amounts to around an additional £300m of interest-free resource borrowing for the Scottish Government in 2021-22 which will need to be addressed in Budget 2024-25.

92. A key role for the Committee is monitoring and assessing the level of that risk. To do so there is a need to comprehend the differences in judgement made by the SFC and OBR especially in relation to their income tax forecasts which have a considerable impact on the size of the Scottish Budget. The Committee therefore invites the SFC and OBR to jointly consider how information can be provided at future fiscal events which explain differences in judgement and how these impact on the net tax position.

93. The Committee also recommends that the review of the Fiscal Framework should consider the extent to which the impact of COVID-19 has magnified the risks arising from a Budget based on two different sets of forecasts prepared at different times.

Scotland’s Relative Tax Performance

94. An understanding of Scotland’s relative tax performance is an essential element of the Committee’s budget scrutiny. As noted above, the Fiscal Framework is designed to protect the Scottish Budget from symmetrical UK-wide macroeconomic shocks, but differences in either economic performance or in tax policy will affect the budget. Even when overall economic performance is broadly similar, there is a risk that differences in the composition of the tax base may result in faster or slower growth in tax revenues in Scotland, for example when earnings growth is unequally distributed.

95. The MTFS recognises that “Scotland’s historic tax performance has been mixed to date.” In 2017-18, Scottish receipts per head grew less quickly than in the rUK, resulting in a net loss to the Scottish Budget of -£97 million while in 2018-19 the opposite was the case resulting in a £119 million net gain to the Scottish Budget.

96. The MTFS notes that there is some evidence that the shortfall in 2017-18 “was linked to the downturn in the oil and gas industry and wider North Sea supply chains, which resulted in a loss of high-paying jobs in the Aberdeen area.” The shortfall would have been higher if Scotland had maintained the same rates and bands as rUK but the changes in tax policy in 2017-18 are “estimated to have generated an extra £108 million.”

97. The net gain to the Scottish Budget from income tax receipts in 2018-19 was largely due to changes in tax policy. The introduction of the five-band regime is “estimated to have raised at least around £300 million, compared to a scenario where Scotland had maintained the same rates and bands as the rUK.” The MTFS states that there is some evidence that Scotland’s economic and income tax performance “may have improved compared to 2017-18, albeit only marginally: the gap in average earnings growth narrowed and GDP growth was broadly similar in both countries in that year.”

98. But taking account of income tax policy changes points “to continuing weakness in Scotland’s Income Tax base, relative to the rUK’s.” The MTFS states that this “could be due to Scotland’s economic growth being less tax rich, lower employment growth and differences in the composition of the tax base.” From 2019-20, however, there is “a significant improvement in the underlying economic data, in particular on earnings growth, and PAYE liabilities from the real time information (RTI) system.”

99. A further risk to the Budget which the Committee has considered previously is that weaknesses in tax performance can also persist over time. This is because of the impact of poor performance on the net tax position in following years. Even if Scottish and rUK revenues per capita grow at the same rates following poor performance in 2017-18 and 2018-19, this will merely maintain the proportionate size of the existing gap between Scottish revenues and the BGA, rather than helping to close it. As pointed out in the MTFS, for “this gap to close, Scotland would need a year of significantly faster receipts growth.”

100. The MTFS identifies a number of factors which can affect Scotland’s relative tax performance, including —

- Growth in earnings, pensions and property income: Growth in wages is one of the key drivers of Income Tax performance.

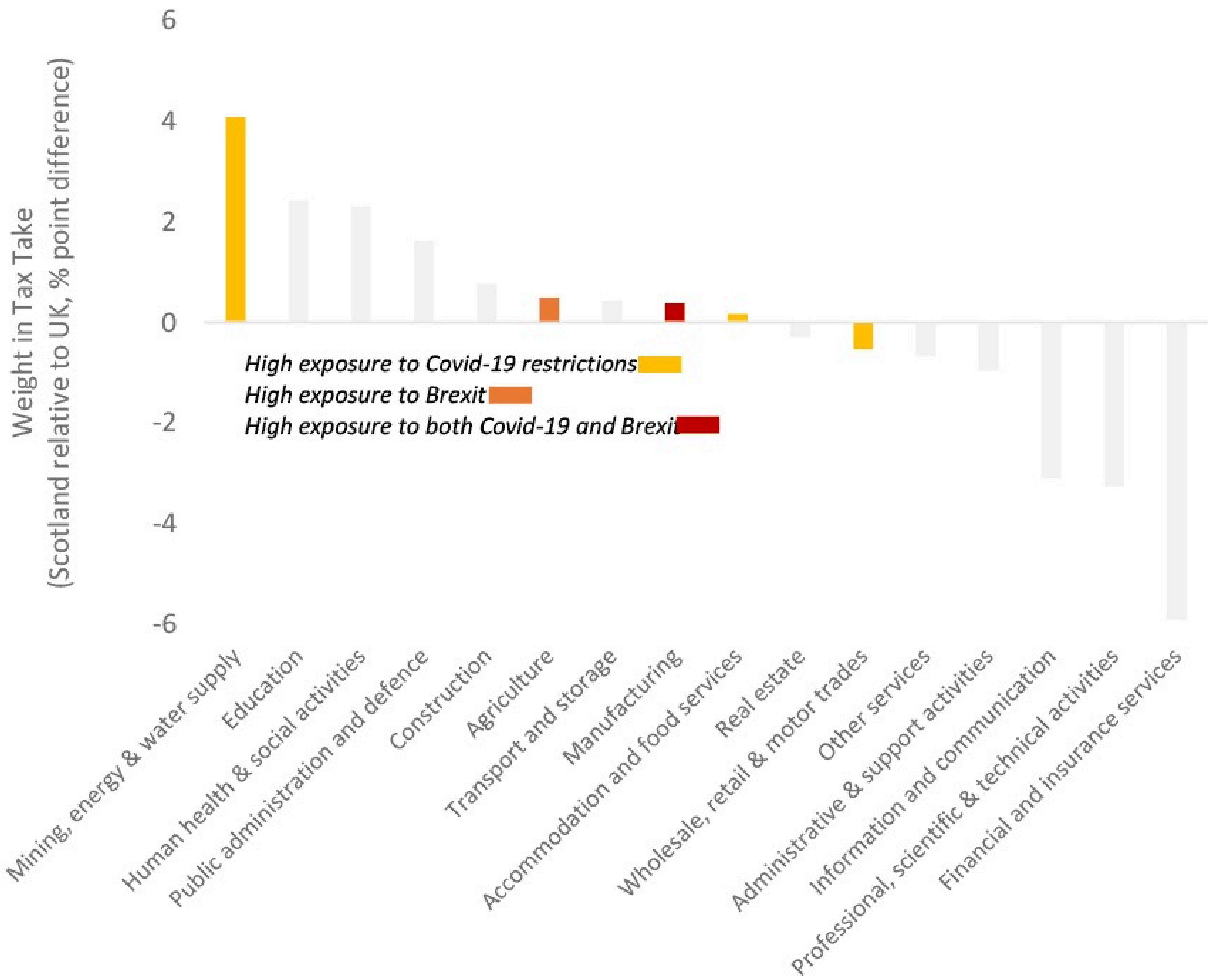
- Growth in the number of taxpayers: This in turn depends on growth in the (working age) population, the performance of the Scottish labour market as well as decisions around the UK-wide Personal Allowance which may lift some taxpayers out of paying tax altogether. The Fiscal Framework protects Scotland against its relatively slower population growth as it operates on a per head basis.

- Differences in the composition of the tax base, including the relative contribution of high Income taxpayers and their earnings growth.

- Policy changes and resulting changes to taxpayers' behaviours, including out-migration or a reduction in the number of hours worked. [50]

101. The MTFS states that "there is a considerable risk that the Scottish Income Tax base might prove less resilient to COVID-19 and the UK's exit from the EU than the rest of the UK's, simply due to differences in the sectoral composition of the two economies." This is because in 2017-18, "Scotland raised around 22.3% of its total Income Tax take from sectors disproportionately impacted by these shocks, compared to only 17.7% in the rUK." This is shown in Figure 4.

Figure 4: Estimated Share (%) of Total Income Tax Receipts generated by Sector



Source: Scotland's Fiscal Outlook: The Scottish Government's Third Medium-Term Financial Strategy

102. The MTFS highlights the impact of the Mining & Quarrying sector which accounts for a much larger share of the overall tax take in Scotland than in the rUK. The MTFS acknowledges that this might be partly offset by Scotland's relatively greater reliance on the public sector where earnings and employment have held up relatively well, compared to the private sector. While the UK Government's fiscal measures such as the furlough scheme have so far masked underlying regional trends, differences are likely to emerge according to the MTFS when these measures are withdrawn.

Distributional Issues

103. In previous budget reports the Committee has explored whether there may be distributional issues within the tax base in Scotland relative to rUK which may have a structural impact on how the Fiscal Framework operates. These are —

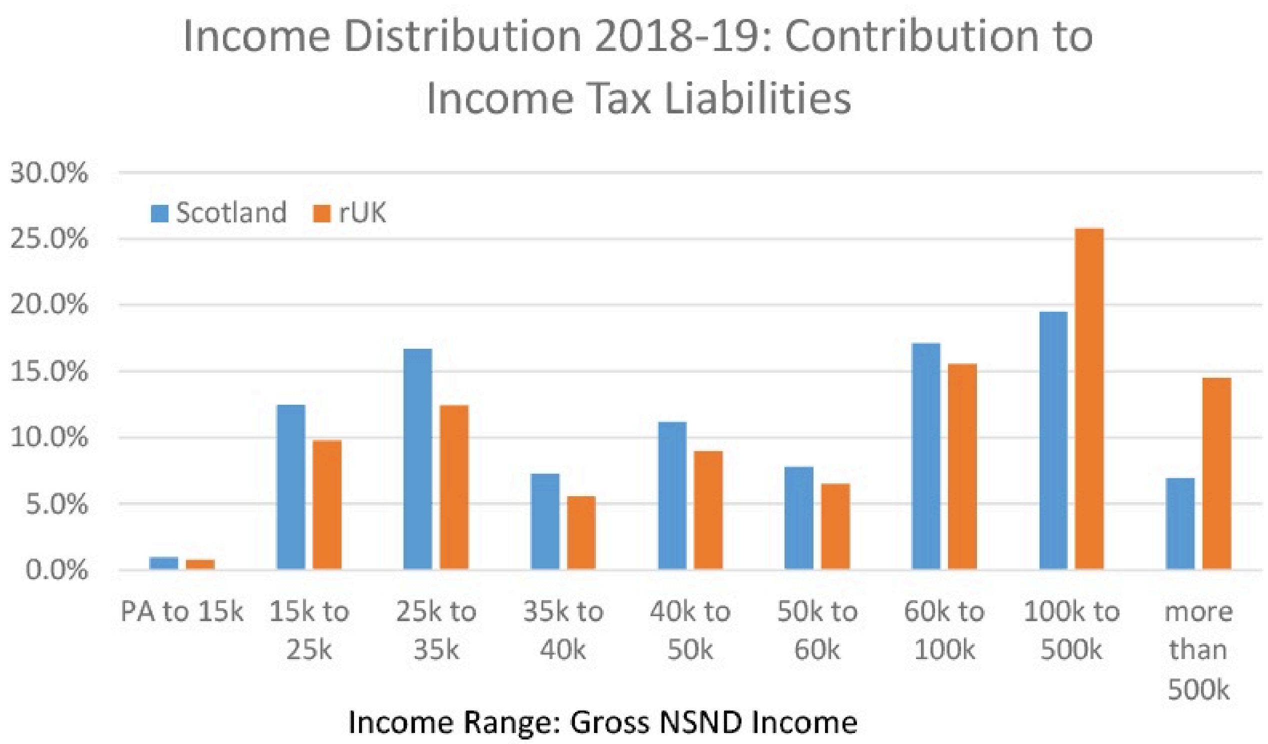
- The extent to which the distribution of the tax base is more unequal in rUK relative to Scotland;
- The extent to which annual earnings growth is more unequal in rUK relative to Scotland.

104. The Committee recommended in our report on Budget 2020-21 that the SFC reflect on these issues in advance of the next round of income tax forecasts. The SFC published a report in October 2020 in which they sought to answer the question “to what extent did the distribution of income contribute to slower Scottish income tax revenue growth in 2017-18 compared to the UK?” [51]

105. The SFC concluded that “the distribution of income only played a limited role in explaining divergent income tax revenue growth.” In their view slower revenue growth in Scotland compared to rUK “can be explained by broad-based slower growth in the Scottish economy and aggregate income.” Indeed, they found that “all else equal, the current distribution of income and Scotland’s tax system favours slightly faster growth in income tax revenues for a given amount of income growth compared to the UK.” The SFC suggest that while “only worth around £20 million in any one year, this effect will build over time.” [52]

106. The Scottish Government would appear to have a different view based on their analysis of the 2018-19 data. The MTFS states that “significant differences in the distribution of the Income Tax base in Scotland and the rest of the UK also pose a notable risk to the Scottish Budget, albeit to a lesser extent than differences in economic performance.” As shown in Figure 5 the available data for 2018-19 shows Scotland had relatively more taxpayers in the £15,000 to £40,000 NSND income bracket than the rest of the UK. It also shows that the proportion of taxpayers earning £100,000 or more was considerably higher in the rest of the UK than in Scotland while incomes per head in that cohort were also 21% higher in the rUK.

Figure 5: Differences In The Income Distribution, 2018-19



Source: 2018-19 Income Tax Outturn Statistics, HMRC

107. This means that Scotland raised a relatively smaller proportion of income tax liabilities from individuals earning £100,000 or more in 2018-19 (26% vs. 40%). It also means that UK-wide factors such as the increase in the UK-wide Personal

Allowance, will have a relatively greater impact on Scottish liabilities. This is because changes to the personal allowance disproportionately affect income at the basic rate and Scotland has a higher proportion of tax payers in that cohort relative to rUK.

108. The Scottish Budget is, therefore, made relatively worse off by increases in the Personal Allowance**.** The MTFS points out that UK and Scottish Ministers agree that the impact of Personal Allowance increases on the Scottish Budget should be accounted for, in line with the spillover provision in the Fiscal Framework. But UK Ministers believe that only above inflation increases in the Personal Allowance should be accounted for while the Scottish Government believes that all increases should be accounted for. This issue remains unresolved.

109. The Cabinet Secretary for Finance wrote to the CST in December 2020 to set out her view on this issue, and to note that it may be necessary to engage the Fiscal Framework's dispute resolution procedures if agreement cannot be reached. The MTFS notes that further engagement will take place to resolve this issue as soon as possible.

110. The Committee has previously noted that the Welsh Fiscal Framework automatically deals with this issue by using a BGA which accounts for the differences in the composition of the tax base. The MTFS states that the Welsh approach "would be preferable to having to deal with this via a separate spillover claim."

111. The Committee previously issued a joint letter with the Social Security Committee and the Cabinet Secretary to HM Treasury on the scope and terms of reference for the independent report and review of the Fiscal Framework. [53] This included a recommendation that the review should consider whether there are potential structural risks inherent within the Fiscal Framework arising from the distribution of the tax base in Scotland relative to the rest of the UK.

112. The Committee recommends that our successor Committee continues to closely monitor the impact of Scotland's relative tax performance on the Budget. In particular, the considerable risk highlighted in the MTFS that the Scottish income tax base might prove less resilient to COVID-19 and the UK's exit from the EU than the rest of the UK's, simply due to differences in the sectoral composition of the two economies.

113. The Committee recommends that the spillover provision arising from the impact of Personal Allowance increases on the Scottish Budget should be agreed between HM Treasury and the Scottish Government as soon as practical.

Managing Forecast Error

114. As noted above this is the first Budget where a Scotland-specific economic shock has been triggered. The annual cyclical resource borrowing (of up to £600m) lasts for each financial year in which the trigger applies, plus the following two financial years, as the economy and public finances recover.

115. Resource borrowing is from the National Loans Fund, and the repayment period will be between three and five years, as determined by Scottish Ministers at the time of borrowing. Resource borrowing can be drawn down at any point in the financial year. The Scottish Government can change its plans at any point and draw down more or less than planned, subject to the overall limits.

116. We noted in our pre-budget report that the negative reconciliation figure for income tax in 2018-19 is £309m and that this would be deducted from the 2021-22 Budget. The Scottish Government has indicated in the Budget that it plans to "borrow £319 million in 2021-22, largely to manage the negative income tax reconciliation from 2018-19." As borrowing can only occur in the case of negative forecast errors, this is currently the maximum permitted borrowing. Any further negative forecast errors would permit further borrowing during 2021-22 up to the limit of £600 million.

117. The MTFS states that in "order to promote budget stability and maintain flexibility in the Reserve, Scottish Government budgets will assume full borrowing against known and/or forecast Income Tax reconciliations." [54] It also states that it "will assess all planned resource borrowing decisions to smooth the funding trajectory over five years." [55]

118. However, the SFC point out that the Scottish Government is planning to borrow only £207 million in 2020-21 despite negative forecast errors of £302m. This leaves the Scottish Government with an opportunity to borrow a further £93 million (up to the £300m limit) before the end of the financial year. [56]

119. Our Adviser points out that higher borrowing in 2021-22, especially in conjunction with higher borrowing in 2020-21, would push the Scottish Government closer to its total resource borrowing limit. However, there is currently significant leeway: the Scottish Government's borrowing plans would bring total resource borrowing to £505m by the end of 2021-22, well below the £1.75 billion limit. If future forecast errors allow the full use of the £600m temporary borrowing powers this would take borrowing to approximately £870m, roughly half of the overall limit.

120. The Committee invites the Cabinet Secretary to explain why she has not used the further £93m of available resource borrowing in 2020-21 given that the MTFS states that Scottish Government budgets will assume full borrowing against known and/or forecast Income Tax reconciliations.

A Fair and Equal Economic Recovery

121. In this section of the report we consider how Budget 2021-22 supports a fair and equal economic recovery as priorities begin to shift from crisis management to supporting GDP growth and tackling inequalities. We then go on to consider medium-term options for supporting a fair and equal economic recovery.

Differential Social and Economic Impact

122. A key question for the Committee is the extent to which the pandemic has had a differential impact on some sections of the population and some sectors of the economy. As noted in Budget 2021-22 while the "economic and social shock has been severe, it has been felt most acutely and disproportionately across certain sectors, demographics and geographical areas" [57] and has "exposed the fragility of some parts of our economy and our communities." [58]

123. While some sections of the population have been well protected in terms of employment and income other sections have suffered economically. The SFC told us that the "incomes of the well-off have been largely unaffected by the enforced downturn in economic activity, while the incomes of many lowpaid workers and families have suffered." [59] Likewise, while some businesses have done well during the pandemic others have really struggled.

124. The Scottish Government's *Equality and Fairer Scotland Budget Statement* recognises that the effects of COVID-19 "layer on top of existing structural imbalances and are predicted to be particularly severe for people on low incomes." [60] As well as a disproportionately higher rate of positive cases and mortality "they are more likely to experience poorer underlying mental and physical health and are also more likely to be in insecure work without financial reserves." [61]

125. Our Adviser identifies four challenges which both the Scottish Government and the Parliament will need to consider moving forward—

- Differential impacts of the crisis across age, income and education groups;
- Differential impacts of the crisis across places;
- The major impact on learning, especially for children from deprived backgrounds;
- The unwinding of business support measures and more targeted support.

126. The pandemic has led to more job losses, higher rates of furlough and less ability to work from home among younger, lower-income and less-educated people. This relates to the fact these groups of workers are more likely to work in sectors such as non-essential retail, hospitality and leisure, and personal services, that have been subject to shutdowns and where work must be carried out onsite/in-person.

127. An additional challenge is the differential impact of the COVID-19 crisis across different places. In particular, the impact of changes in commuting to work and

shopping and the extent to which this disproportionately impacts on cities. The extent to which the substantial shift to online retail sales and homeworking as a result of the crisis will continue post-crisis is unclear. But it is likely to create both opportunities and challenges as recognised in the MTFS—

- Opportunities include the potential for some communities to retain more spending that is currently spent elsewhere by residents who travel to work and shop in major cities. And greater home working could enable people living further away from major cities and those for whom commuting is difficult (such as those with caring responsibilities) to access more high paid jobs;
- Challenges include closure of businesses, empty properties that need repurposing and unemployed workers who need support to find new work in areas reliant on commuters and shoppers. This could particularly impact major cities like Glasgow and Edinburgh which already have significant pockets of deprivation, but which had been thought to have more fundamentally strong economies than many other parts of the country.

128. COVID-19 has also significantly impacted on schooling and learning which is likely to have long-term educational and labour market impacts. There is a risk that this will have a disproportionate impact on pupils from disadvantaged backgrounds who “may lack the required digital equipment and study space to participate in effective remote learning.” [62]

129. A further challenge will be the timing and pace of the unwinding of business support measures and opportunities for more targeted support. While many of these measures such as the furlough scheme are determined by the UK Government there will also be challenges for the Scottish Government in shifting from *support* measures to allow businesses to get through the crisis to *recovery* measures as the economy emerges from the crisis. In particular, there will be challenges in moving from universal measures to a more targeted approach.

130. The SFC told us that they expect a big increase in unemployment to 7.6% when the furlough scheme ends. They also explained that although we will have a lot of unemployment, we will also have a lot of mismatches across sectors and skills with some sectors being hit hard and struggling while others will struggle to find people who are qualified.

131. The Committee recognises that it is highly likely that COVID-19 has exacerbated existing structural inequalities with particularly severe consequences for people on low or precarious incomes and have fewer employment rights. At the same time the pandemic has had a devastating impact on the economy with some sectors and businesses being harder hit than others.

132. The Committee’s view is that a fair economic recovery from COVID will require proactive measures to reduce wealth and income inequality, and a particular focus on supporting lower income, less educated and younger workers into the labour market. It should also help them progress up the labour market while driving up standards of pay and workplace rights. If the number of jobs in hospitality and non-essential retail is to become a permanent feature, support for training in other sectors and industries is also likely to be important.

133. As we emerge from the national lockdown, the Committee suggests that the Scottish Government considers more targeted business support measures. For example, to protect jobs and businesses in sectors which are particularly exposed to restrictions and temporarily lower demand. Support should also be targeted at incubating emerging businesses and sectors.

The Scottish Government's Response in Budget 2021-22

134. Below we examine some of the immediate policy and budgetary choices which the Scottish Government has made in Budget 2021-22 in seeking to deliver a fair and equal economic recovery. The budget document states that the Scottish Government's "tax choices recognise the impact the pandemic is having on people, households and businesses, underlining our commitment to tackle the inequalities further exposed by COVID-19." [63] It also recognises that the pandemic "has reinforced the urgent need to tackle inequality, and drive progress towards our statutory targets to reduce, and ultimately eradicate, child poverty, by 2030." [64]

135. Budget 2021-22 states that "we invested around £2 billion in support targeted at low income households, including over £672 million to support children in low income families, including our priority groups. We expect 2021‑22 investment to be at a similar level. [65] It also highlights the "ambitious use of our new social security powers to tackle child poverty includes significant investment in our Scottish Child Payment." [66] The expected investment in 2021‑22 is £68 million.

136. A further COVID-related response in Budget 2021-22 is the investment of £25 million to support digital inclusion amongst school‑aged children, expected to support up to 70,000 children from lower income households – and significantly enhanced online and remote learning options for pupils. Local authorities have also been able to use their share of an additional £45 million, as they provide remote learning during lockdown, including for the provision of additional digital devices and connectivity solutions for disadvantaged children and young people.

137. The Committee asked our witnesses whether the Budget sufficiently addresses the unequal impact of COVID-19. The FAI responded that "it is probably a steady-as-she-goes sort of budget in trying to address the real inequalities that have been exacerbated by the pandemic." [67] In their view the Scottish child payment "should be lauded as an innovative measure that Scotland has been able to introduce to deal with child poverty." But "whether it is enough to deal with child poverty to the extent of meeting our statutory obligations is another question, as is whether some of the money for things such as the council tax freeze could have been used differently to further those ambitions." [68]

138. The Scottish Trade Union Congress (STUC) are "concerned that the distribution in the budget is quite regressive." In their view, areas such as the drugs death rate, in-work poverty and an exceptionally high level of child poverty "require urgent

attention in order to reduce the inequalities in our society, but we see little in the budget that will start to do that." [69]

139. The Chambers of Commerce told us that as the crisis continues to "have a devasting impact upon the Scottish economy, many businesses across the country are desperate for action from government to restore confidence and prepare for economic recovery." [70] In their view, the Budget "must provide certainty on long-term business support, job creation and training programmes, infrastructure plans as well as extending crucial business rates reliefs and cashflow support packages." [71] But they also told us that business understands that "the pandemic has shone a light on inequality across all our communities" and "can contribute towards changing that situation, in the right way and at the right time." [72]

140. The Committee asked the Cabinet Secretary how the Budget addresses the disproportionate impact of the pandemic on people on low incomes in ways that are different to the last, pre-COVID budget. She identified three different elements," two of which build on our approach in previous years—the first is pay and the second is tax." [73]

141. On public sector pay policy she explained that it "maintains a distinctive approach that is focused on reducing inequalities by ensuring that the lowest paid get the most significant uplift of 3 per cent" while income tax policy "will continue to be more progressive in terms of supporting the lowest earners." She also referred to the "strong emphasis on reducing inequalities" including the £68 million Scottish child payment and supporting communities through local government that "have been hit disproportionately hard this year." Another example she provided is the council tax freeze which while "not the most flexible of instruments" is also intended to support households that are struggling." [74]

142. The FAI told us that the "council tax is a regressive tax and is likely to account for a larger proportion of the income of those who earn the least, but those in larger properties will get larger benefits from the freeze." They also pointed out that "those on the lowest incomes are already likely to be benefiting from council tax reductions, so they will get a limited benefit from the council tax freeze." [75]

143. COSLA point out that it is their long-held view that "there should not be a cap on council tax; it is absolutely a local tax." However, Council leaders "will find it difficult not to take that compensation and impose a freeze." COSLA told us that Council "leaders understand their communities and the pressures on households at the moment, and would probably have applied fair prudence anyway." [76] Their position is that if the £90m is not sufficient to cover the shortfall they "will need to go back to the Government and ask for more." [77] COSLA also pointed out that "if we freeze council tax this year, that will artificially reduce the tax base, which will cause problems in future years." [78]

144. The STUC welcome that the weighting of the public sector pay policy (PSPP) "favours low-paid workers. However, it does not go far enough." They point out that many public sector workers earning between £25,000 and £36,000 "have been working extremely hard and going above and beyond throughout this pandemic." In their view the PSPP "fails to deliver" an economic stimulus mechanism "when we start to consider the number of workers who will not see much of a pay rise at all."

[79] They "would like the Scottish Government to look again at the public sector pay settlement." [80]

145. The Committee asked the STUC whether there are areas in the Budget which they would propose amending to fund higher pay increases. They responded that they "would certainly ask whether the £90 million that is being spent on a council tax freeze and the £50 million that it is estimated it will cost to give what is, in effect, a tax break for higher earners could be better spent elsewhere." They would also "probably question whether a blanket rates rebate approach is the right one."

146. COSLA pointed out that that they are about to "enter some quite sensitive pay negotiations at a time in which the workforce is feeling a bit wearied and underappreciated" and this will "make things incredibly challenging when we only have a 0.9 per cent uplift in our own budget." [81] They told us that "the 0.9 per cent increase to £95 million will go less than halfway towards paying for an uplift in pay." Matching the PSPP "would cost £205 million, so the £95 million will not cover even the most modest pay increases." [82] COSLA's view is that "to reach a reasonable settlement with the unions, we will need to see an increase in our core budget." [83]

147. In the limited time we had available to scrutinise Budget 2021-22, the Committee heard a range of views from our witnesses regarding budgetary priorities. Ultimately though these are political choices for the Parliament to decide. The Committee recommends that in doing so the Parliament reflects on the issues raised in this report and specifically, the extent to which the Budget —

- differs from the last pre-COVID Budget in focusing on the disproportionate impact of the pandemic;
- should allocate all of the funding available given the on-going substantial uncertainty and volatility;
- sufficiently addresses the levels of risk identified in the MTFS that the Scottish Income Tax base might prove less resilient to COVID-19 and Brexit due to differences in the sectoral composition of the UK and Scottish economies;
- provides the right balance in terms of funding to support creating jobs and investing in a sustainable recovery while tackling inequalities;
- if the balance is not right, whether this can be addressed through the allocation of additional funding from, for example, increased Barnett consequentials.

148. However, the Committee also recognises that addressing the impact of the pandemic is enormously challenging and will require a longer-term strategy.

The Scottish Government's Response in its Medium Term Financial Strategy

149. The MTFS states that it provides the context for the Scottish Budget that will govern the life of the next Scottish Parliament and will frame the decisions of the incoming Government's strategic approach to economic and fiscal policy.

Capital and Infrastructure Investment

150. The MTFS states that the Capital Spending Review (CSR) and Infrastructure Investment Plan (IIP) address the significant medium-term challenges presented by the COVID-19 pandemic. Approximately £33.5 billion of capital investment will be provided over the next five years supporting 45,000 full-time equivalent jobs over those years. Annual infrastructure investment is expected to be £1.56 billion higher in 2025-26, when compared with a 2019-20 baseline.

151. The Chambers of Commerce told us that they "liked the announcement about the national infrastructure plan. That has been one of the key tools in the box that the Government can use to create an environment in which business can look at a recovery." [84]

152. The 2021-22 capital budget from HM Treasury is £4,973 million, a 5% increase in cash terms compared with 2020-21. The Scottish Government plans to further boost capital expenditure in 2021-22 through a combination of mechanisms—

- Using maximum borrowing powers (£450 million).
- Using Financial Transactions (FT) funding from the UK Government and recycling receipts received from previous loans made using FTs (£552 million).
- Capital grant receipts and other income (£63 million).
- Making use of innovative finance mechanisms, such as the Growth Accelerator and Tax Incremental Financing (£50 million).

153. These additional financing sources will mean total capital investment in 2021-22 of £6,089 million, which is 2.5% lower than the equivalent planned infrastructure spending for 2020-21 (£6,243 million). This reduction is primarily driven by lower Financial Transactions funding.

Financial Transactions (FTs)

154. The 2021-22 Budget includes £552 million for FTs including repayments. Net financial transactions (after adjusting for receipts) total £408 million. The amount allocated by HM Treasury to the Scottish Government in FT funding has reduced by around two-thirds in 2021-22, from £606 million in 2020-21 to £208 million in 2021-22. However, the Scottish Government plans to draw down £200 million from the reserve built up from previous underspends on FT allocations and will also supplement the FT budget by using repayments from earlier FT loans.

155. For 2021-22, a total of £142 million (gross) in financial transactions has been allocated to housing-related schemes. The Scottish Government is also providing

equity/loan finance support in areas other than housing. In 2021-22, £204 million (gross) in FTs will also be used to provide upfront capitalisation for the Scottish National Investment Bank (discussed further below).

156. A further £236m in capital consequentials and £41m of FT consequentials for 2020-21 was announced by HM Treasury on 16 February and the Scottish Government is able to carry these over to 2021-22. The Cabinet Secretary told the Parliament that a further £100 million grant and £20 million in financial transactions for affordable housing has been allocated in 2021-22.

157. The Cabinet Secretary told us that she firmly believes that "investing in infrastructure will be a key part of our recovery." [85] She stated that the "capital spending review includes the £2 billion low-carbon fund, to be spent over the next five years, central to which is an investment of around £1.6 billion for heat and energy efficiency in our homes and buildings." [86] This is aimed at meeting climate change targets as well as revitalising the economy.

158. The Cabinet Secretary was asked why the More Homes allocation has been reduced by £268m when compared to the 2020/21 Budget. She responded that this is due to the UK Spending Review which cut the capital budget "and the biggest proportion of that cut was to financial transactions, the bulk of which would normally support affordable home ownership and investment in charitable bonds." [87]

159. The Cabinet Secretary also pointed out that the affordable housing budget also needs "to be looked at in the broader context of the reduction to capital of 5 per cent, as well as the reduction to FTs." [88] She explained that she has protected the FT money going to the Scottish National Investment Bank (SNIB) and has "also tried to protect the affordable housing programme as far as we can." [89]

160. The Cabinet Secretary told us that the SNIB "will play a critical role when it comes to economic recovery, and affordable housing is part of its remit" which underpins her point that "there is a broad package of support when it comes to affordable housing, to ensure affordable housing supplies." [90] She was asked by the Committee how much the SNIB has invested from its allocation of £240m in 2020-21.

161. The Cabinet Secretary responded that it has only been operational since November 2020 but the outturn statement in a couple of months' time should provide clarity on what the bank has actually used—largely as a result of changing priorities over the course of this year because of the pandemic—versus what we budgeted would be used.

162. The Committee requested that she confirm in writing how much of that £240 million budget the bank has invested. She responded that it "has committed to two investments with a further three investment commitments planned before the end of the financial year."

Capital Borrowing Powers

163. The Scottish Government is able to borrow up to £450m in each year for capital

investment, up to a cumulative total of £3 billion. The Budget sets out plans to borrow the maximum £450 million in capital borrowing to support infrastructure expenditure in 2021-22. According to the SFC, the borrowing plans for 2021-22 bring the cumulative total borrowing to £2.2 billion. They assessed the Scottish Government's capital borrowing plans as reasonable but noted that, if borrowing continues at the maximum of £450 million per year, then the £3 billion cap will be reached by 2024-25, which will limit future options.

164. The Committee agrees with the Cabinet Secretary that investing in infrastructure including the £2 billion low-carbon fund will be a key part of economic recovery. The Committee also recognises that prioritising low-carbon infrastructure will be an important element of meeting the Scottish Government's climate change targets. The Committee believes that it is essential that this investment addresses the differential sectoral impact of the pandemic on the Scottish economy. The Committee recommends that given borrowing costs are extraordinarily low, HM Treasury considers increasing the Scottish Government's capital borrowing powers as a value for money means of supporting economic recovery.

165. At the same time the Committee recommends that it is essential that the Scottish Government makes full use of its existing powers including the role of the Scottish National Investment Bank in supporting economic recovery from the crisis.

166. The Committee also recommends the need for more transparency regarding the Bank's investments including the commitments identified by the Cabinet Secretary arising in 2020-21.

Tax Policy

167. Our Adviser points out that the MTFS does not really provide a sense of how the Scottish Government may respond to different economic and budgetary scenarios – such as via spending allocations/prioritisation, tax policy change, or use of its existing fiscal flexibilities. In his view this means that the MTFS is more of a high-level overview of the context in which future budgets will be set, including scenarios for funding and spending.

168. The Committee asked the Cabinet Secretary whether the MTFS should develop into more of a strategy that sets out the Scottish Government's general direction of travel on issues such as tax, spend, borrowing and the potential for fiscal consolidation to result in further austerity measures. She responded that it "sets out the context for budget decisions, and actual decisions on tax and spend are reserved to the budget or a spending review." While she recognises there "are legitimate questions about how we do multiyear spending and on setting out our approach to multiyear tax and spending plans" she points out that we are still awaiting a spending review from the UK Government due to the pandemic. [91]

169. The Committee's view, however, is that the recovery from the pandemic provides a significant opportunity to develop a more strategic approach to the Budget. This

needs to take place outwith the annual budget process.

170. A key question will be the extent to which fiscal consolidation can be achieved alongside supporting economic recovery and tackling the differential societal impact of the virus. In particular, how to tackle the structural inequalities in our society many of which have been exacerbated by the crisis. This will require the consideration of radical policy solutions including whether the current devolved taxation structure needs to be reformed to tackle the enormous challenges arising from the pandemic. We asked our witnesses whether Scotland is ready for that wider debate on tax reform.

171. The FAI told us that such a debate is tricky given the partial devolution of some taxes and the reserved nature of others and “the interactions between them; for example, how capital gains tax interacts with people who come out of income tax.” The FAI also suggested that the debate on how to tax land and property in Scotland and on whether the non-domestic rates system is fit for purpose have also been crystallised by the pandemic.” [92]

172. The FAI’s view is that “additional revenues from higher income tax rates in Scotland than those prevailing in rUK are largely offset by lower rates of council tax. Combined with its policy on business rates, the prevailing view of the Scottish Government as a tax-raising government can be debated.” [93]

173. The Chambers of Commerce suggested that business would support a debate on tax reform in Scotland but that timing is important. They highlighted the “broken system of non-domestic rates, and the fact that some businesses benefit from grant support when they do not need it while other businesses need that support more.” [94]

174. The STUC “want tax to be used more as a tool to support fair work and create the social changes that the Scottish Government tells us it is committed to.” [95] While they “agree that we have to save jobs and do everything that we can to protect businesses” they question “whether a blanket tax break for all businesses is the type of support that will result in the best outcomes.” [96]

175. The Committee recognises that the fiscal and economic challenges arising from COVID-19 are enormous. But crisis can also trigger new ways of thinking. As we begin to shift focus from crisis management to recovery it is essential that the differential impact of the pandemic especially on low-income families is addressed.

176. At the same time this forces us to re-examine the persistent structural inequalities in our society and which have been exacerbated by the current crisis. This should include how the structure of devolved taxes could be reformed to support a fair and equal economic recovery.

177. Whilst we have previously recommended that our successor Committee revisits our inquiry on a Scottish approach to taxation we now consider that a more fundamental examination of what the Scottish tax system is designed to achieve must be undertaken. In particular, the role of tax policy in achieving a just,

sustainable and strong economy as we recover from COVID should be considered. The review should also include the following —

- the breadth and nature of the tax base;
- the impact of economic activity on the size of the tax base;
- the relationship between local, Scottish and UK-wide taxes.

178. The Committee's view is that this requires a national conversation jointly led by the Government and Parliament and which includes a wide range of voices across Scotland. If the work were to be completed by September 2022 this would allow the Parliament and our successor Committee to consider its findings as part of its pre-budget scrutiny prior to the publication of Budget 2023-24. It would also allow the Government to consider the findings in preparing its 2023-24 Budget.

Replacement of EU Structural Funds

179. Following the end of the transition period and as a non-EU state, the UK no longer participates in the EU's structural funding programmes and the UK Government has confirmed it will establish a UK-wide Shared Prosperity Fund (UKSPF) to replace these funds. EU Structural Funds aimed to reduce economic inequalities between regions with the most recent programme (from 2014-2020) focussing on delivering smart, inclusive and sustainable growth. As noted above, however, the pandemic has exacerbated the unequal outcomes between different groups that existed pre-COVID.

180. On 4 October 2019, the Committee reported its views on Funding of European Union Structural Fund priorities in Scotland, post-Brexit [97] . In its report the Committee welcomes the replacement of EU structural Funds given they are valuable funding for communities and that—

> We consider the decision taking powers that the Scottish Government currently exercise under the EUSF should not be reduced under the UKSPF. The flexibility for the Scottish Government to distribute its post-Brexit UKSPF funding according to its priorities should be no less than that currently available under the EUSF.

181. Although the 2014-2020 programme of EUSF has finished, Scotland will continue to benefit from up to £738 million in funding allocated from that programme. The Minister for Trade, Innovation and Public Finance (hereafter referred to as 'the Minister') confirmed that the bulk of that funding has been committed and that "We have three more years in which we can continue to allocate the funds." [98]

182. On 25 November 2020 the Chancellor of the Exchequer confirmed further details for the UKSPF including that—

- It will be a UK-wide fund "to level up and create opportunity across the UK for people and places".
- the "total domestic UK-wide funding will at least match current EU receipts, on average reaching around of £1.5 billion a year".
- a UK-wide investment framework will be published in Spring 2021 with its funding profile announced at the next Spending Review;
- the UK Government would provide £220 million to "help local areas prepare over 2021-22 for the introduction of the UKSPF"

183. The UK Government committed that it would "respect the devolution settlement" and engage with the devolved Administrations "to ensure the fund works for all places across the UK." [99]

184. On 19 November 2020, the Scottish Government published its plans for replacement of EU funding, proposing a Scottish Shared Prosperity Fund which aims to reduce economic and social disparities within and between places and people in Scotland.

185. The Minister acknowledged that there is broad alignment between the UKSPF aim to increase productivity and the levelling up agenda, and the Scottish Government's inclusive growth agenda and its ambition for all parts of Scotland to be included. However, he highlighted that the mechanisms used to deliver those aims must align with the Scottish Government's policy objectives. If not, he warned of confusion and more bureaucracy at the delivery end—

> We would have local authorities and delivery agents trying to match up criteria that come from the Scottish Government and other funding streams, in alignment with the national performance framework, with a different set of criteria that would come from the UK Government.

186. The Scottish Government explains that its funding framework is based on the expectation that the UK Government will honour its commitment to "at a minimum match the size of those funds in each nation" [100] and commit to transferring at least £183 million per year to the Scottish Government to replace the EU Structural Funds, and the European Territorial Cooperation and LEADER programmes. This equates to a 7 year replacement programme of £1.283 billion. [101]

187. The fund is also built on the assumptions that the programme will be multiannual with Scotland able to allocate funding to the places and priorities that the Scottish Government chooses. The Scottish Government explains that its funding framework sets out the high level aims of the programme but that without further information from the UK Government it isn't possible to develop it further.

188. The Minister was disappointed to learn in January 2021 that the UK Government intends to deliver the UKSPF throughout Scotland on its own. He noted that it is possible that much of the fund may be delivered by the Ministry of Housing, Communities and Local Government which appears to have "no locus at all in Scotland." [102]

189. The Minister explained that both he and Scottish Government officials stand ready to work on a pan-UK basis on future plans for a UKSPF but that despite repeated attempts to engage with the UK Government, he was "not seeing any evidence at all of any desire to collaborate, which is hugely disappointing." [103]

190. Whilst we welcome the UK Government's stated commitment to collaborate with the devolved Governments, to respect the devolution settlement and "to ensure the fund works for all places across the UK," it is not yet clear how this commitment is being delivered.

191. Without collaboration there is a risk that the allocation of funds from the UKSPF could be used to deliver contradictory or competing outcomes to funding from the Scottish Government in the same policy areas. This risk must be avoided if the UKSPF is to be a valuable and effective tool in addressing the impact of COVID-19 on widening inequalities.

192. It is frustrating that having now left the EU it remains unclear exactly how the UKSPF will operate. As highlighted by the Cabinet Secretary for Finance, UK Government decisions on replacement of EU funding could have consequences for the Scottish Budget given from 1 January 2021 "no new funding will be

available to various programmes, which will lead to disruptions in project delivery across Scotland." [104] As we have previously reported the ongoing uncertainty about the UKSPF adds another layer of potential volatility to the Scottish Budget.

193. It also remains unclear how the UK Government's transition funding of £220 million in 2021/22 will be allocated. The UK Government and Scottish Government must work together to agree the level of and allocation criteria for this 'transition' funding in Scotland as a priority so that it can be rapidly dispersed to help address some of the economic and social impacts of COVID-19.

Scottish Parliamentary Corporate Body

194. The Committee is required to consider the budget proposal from the Scottish Parliamentary Corporate Body (SPCB). The SPCB has a prior call on the Consolidated Fund, meaning that its budget is allocated before the Scottish Government makes any other allocations. The SPCB budget provides for the costs of the Parliament and also the costs of the Ombudsman and Commissioners (termed 'Officeholders') which fall within the definition of SPCB supported bodies.

195. The SPCB Budget [105] was submitted to the Committee on 9 December 2020 and the Committee took oral evidence on it at its meeting on 13 January 2021 [106] . The Committee raised two substantial issues with the SPCB: the impact of Brexit and Commissioners' pay.

The Impact of Brexit

196. In October 2020, the Committee undertook a consultation [107] with parliamentary committees on the impact of Brexit on devolution and how the Parliament's scrutiny role will need to evolve to address this impact. A summary of all the responses was published on the website. [108]

197. Following a Chamber debate on the consultation findings the Committee wrote to the Presiding Office on 8 December. We stated that greater scrutiny capacity within the existing committee structure is now needed to address the substantial increase in committee workloads arising from the impact of Brexit. We also stated that we recognise that given the tight fiscal environment this may require difficult conversations about reprioritising existing resources, but this needs to start now, before the next session of Parliament begins.

198. The Presiding Officer responded that there are a range of issues vying for investment and the SPCB will need to prioritise these in a way which best addresses Parliament's needs and offers best value to the public purse. It is our intention to review staffing resources, especially across the scrutiny areas, to better inform a more robust and sustainable staffing baseline for 22/23 onwards.

199. Since then our expert legacy panel has recommended that the Parliament in consultation with the Scottish Government needs to clearly define its scrutiny role in response to Brexit. The Panel's view is that there is a real risk that there is not sufficient existing capacity to carry out this additional work effectively.

200. The Committee notes that a key issue in determining the Parliament's scrutiny role in response to Brexit will be resources. But there is a risk that the level of additional scrutiny required by the complex constitutional consequences of Brexit is determined by the level of available resources. The Committee's view is that in contrast, discussions about increased resources need to flow from an initial consideration of the level of additional scrutiny and this needs to happen prior to the start of Session 6.

Members’ Staff Cost Provision

201. The Committee notes that the SPCB has agreed to increase the level of staff cost provision in Session 6 from £93,000 to £133,200 per member following a review of the Staff Cost Provision (SCP). The SPCB states that the review had shown clear evidence of increased and sustained pressure on the SCP in a range of areas including rapidly rising case work demands. This has resulted in a £5.8 million increase in the SCP provision in the SPCB budget for 2021/22 including an uplift of 2.7 percent in line with the annual uprating provision agreed by the SPCB in March 2020.

Commissioners’ Pay

202. The Committee asked the SPCB whether Commissioners were following the lead of Ministers and MSPs in not taking a pay rise in 2021-22. The Clerk/Chief Executive responded that commissioners’ pay is set by the SPCB but that it has not yet taken a decision in relation to 2021-22.

203. The Scottish Public Sector Pay Policy includes a pay increase at up to 1 per cent for all Chief Executive appointments, except where the current salary is £80,000 and above, in which case the pay increase will be limited to £800.

204. The Committee’s view is that the SPCB should be cognisant of Ministers and MSPs not taking a pay rise in 2021-22 when deciding Commissioners’ pay for next year.

Annexe A

Allocation of Barnett Consequentials

On 8 December the Cabinet Secretary informed the Committee that further funding allocations arising from Covid-related Barnett consequentials have been provided as follows—

- Around £600 million has been provided to health and social care, wider public health initiatives and welfare support. This funding supports the public health response to Covid including: vaccinations and test and trace; the £500 non-consolidated payment for health and social care staff; and the Winter Plan for Social Protection, which helps people pay for food, heating, warm clothing and shelter as well as free school meals over the school holidays and the self-isolation support grant.

- Support for business and the wider economy of £570 million, including grants via the Strategic Framework, funding for local support packages, the newly self-employed hardship fund, digital support, Local Authority Discretionary Business Funding and remaining allocations from the £97 million support for culture and heritage.

- Previously announced support for Local Government, relating to the estimated £90 million Lost Income Scheme as well as £49 million of additional funding confirmed to councils in September. Added to additional funding already committed, this brings the value of the overall support package to councils to more than £1 billion.

- Around £500 million of funding to support continued provision of transport and funding for income shortfalls within our partner bodies including Police Scotland, the Scottish Funding Council, Registers of Scotland and the Scottish Courts and Tribunals Service in order to ensure that they can continue to deliver vital services, as well as mitigating shortfalls in devolved tax as a direct result of Covid-19.

- Due to the nature of the Covid-19 outbreak, the potential asks for further demand led spend with regards strategic framework support for business in Scotland and additional demands on health, and the requirement that the funding provided to date will cover all costs until the end of March 2021, I have allocated £330 million of funding in order to support these asks. This is consistent with the terms of the funding guarantee provided by HM Treasury to the devolved administrations, which specified the funding was to cover the period until March 2021. This contingency is also required in order to support any additional funding requirements as a result of the end of the EU transition period.

The Cabinet Secretary subsequently provided further details of how Covid-related Barnett consequentals are being allocated in a letter dated 28 January as follows—

- Further support of circa £300 million to business, including funding to support payments from the Strategic Framework Business Fund following the introduction of further lockdown measures, a one-off top up to the grant support for hospitality, retail and leisure businesses, comparable support for island businesses, and increased funding for taxi and private hire drivers impacted by the pandemic. This week a range of sectoral support schemes have opened, as announced in December, including an augmented and innovative £25 million Scottish Wedding Industry Fund.

- An immediate doubling of the Local Authority Discretionary Fund, which means that a total of £60 million will now be available in this fiscal year to support local business needs.

- An increase of £110 million to the initial £90 million allocation to the Local Government Lost Income Scheme to compensate councils for the loss of income from sales, fees and charges due to the pandemic. This results in an overall allocation of £200 million for this purpose, which when added to the previously committed £49 million consequentials that could also be used to support lost income for council arm's length external organisations will provide an extra £249 million.

- Additional Covid related support of circa £140 million which includes funding for education and justice, such as funding for University Student hardship, education recovery and the Scottish Government's package of support for the legal aid sector.

- This leaves £180 million of contingency to support any further demand led spend towards the end of this financial year and into 2021-22, and ensure effective year-end management, as required. This represents a very small proportion of the overall annual Scottish Government budget and the funding guarantee.

The Cabinet Secretary wrote to us on 22 February providing details of further non-recurring COVID support in 2020-21 as follows –

- £275 million to support Covid pressures including for lost income in Local Government.

- £40 million for local government to support the ongoing deployment of safety mitigations within schools. This builds on the £50 million previously committed and provides certainty to local government as it proceeds with the phased reopening of schools and ELC settings.

- £60 million for Further and Higher Education to maintain research activity, protect jobs and help students.

- £25 million to tackle poverty and inequality.

- £5.7 million to support Covid pressures on Forestry.

Annexe B

Table 6: Allocation of COVID-related consequentials carried over to 2021-22

Resource	
Non-domestic rates: • extension of 100% relief for retail, hospitality and leisure to full year (on top of pre-existing proposal for initial 3 months) • further year of relief for newspapers • extension of relief for independent schools (on top of pre-existing proposal for initial 6 months)	£534m
Anti-poverty measures	£100m
Mental health	£120m
Education catch-up	£60m
Health & Social Care recovery	£60m
Total Resource	**£874m**

Capital grant	
Housing	£100m
Fuel poverty & energy efficiency	£45m
Town Centre Fund & 20-minute Neighbourhoods	£50m
Local bridge/maintenance fund	£32m
Rural Tourism Infrastructure Fund	£10m
Total Capital	**£237m**

FTs	
Scottish Enterprise	£21.5m
Housing	£20m
Total FTs	**£41.5m**

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